

This is an email I received from one of Senator Grassley's staff. First, there is a news release and then the letter sent from Senator Grassley to the IRS Chief Counsel. Both of these documents concern a situation that may be similar to the situation Farm Journal Media is bringing to the attention of the FCC. My understanding is that the Senate Finance Committee has been working on problems involving non-profit organizations, including competition between them and commercial, tax-paying entities. The FCC may be interested in this work of the Senate Finance Committee and the IRS' answers to the Committee's questions, in helping to resolve the issue at hand in this docket, 06-92.

From: "Gerber, Jill (Finance-Rep)" <Jill\_Gerber@finance-rep.senate.gov>

To: <sales@bartinst.com>

Subject: news release

Date: Wednesday, June 14, 2006 10:22 AM

Ms. Bartlett - Just wanted to let you know we're sending this news release out today. Thank you for your help. - Jill, 202/224-6522

For Immediate Release

Wednesday, June 14, 2006

Grassley Goes to Bat for Iowa Company Facing Competition from Non-profit Group

WASHINGTON - Sen. Chuck Grassley, chairman of the Committee on Finance, with jurisdiction over taxes, is seeking Internal Revenue Service (IRS) comment on concerns raised by an Iowa company that it is facing inappropriate competition from a non-profit group.

Bartlett Instrument Company, a small manufacturing company in Fort Madison, makes temperature controls for ceramic kilns and greenhouses. The company is concerned that a tax-exempt foundation, the Edward Orton Jr. Ceramic Foundation, is operating like a manufacturing company rather than a tax-exempt organization. Grassley said the company's situation exemplifies a

broad concern that the IRS should resolve nationwide.

"As a matter of policy, a manufacturing company pays taxes like any other business," Grassley said. "It's unfair to make a company compete for business with an organization that doesn't have to pay taxes at all and has no significant charitable activity. The IRS needs to clarify what's appropriate business activity for tax-exempt groups and then enforce its findings. Tax-exempt status is a privilege given to those who serve the public good, not those who rack up personal profit."

Grassley described the Bartlett Instrument Company's concerns in a recent letter to the IRS. Grassley is conducting a wide-ranging review of tax-exempt groups' practices. Congress has not comprehensively considered the laws governing tax-exempt groups since 1969, and some entities have exploited the lack of scrutiny for personal gain.

The text of Grassley's letter to the IRS follows.

June 1, 2006

The Honorable Donald L. Korb

Chief Counsel

Internal Revenue Service

Washington, D.C.

Dear Mr. Korb:

As you are aware, the Congress continues to consider several legislative proposals affecting tax-exempt organizations. However, as you are also aware, legislation is not always the easiest or quickest way to correct abuse by and within tax-exempt organizations.

The Internal Revenue Service ("IRS") is granted broad authority under Internal Revenue Code ("IRC") section 7805 to issue regulations and specifically under IRC section 7805(b)(3) to apply regulations retroactively to prevent abuse. It appears that IRS has used this provision as recently as 2005 to prevent abuses in taxable entities. I encourage you to use this tool more frequently and expeditiously, particularly with respect to tax-exempt organizations and in those situations when it is an IRS regulation that may be frustrating congressional intent by permitting an abuse to continue.

I support the positions IRS stated in recent guidance regarding credit counseling organizations and seller-funded down payment assistance programs. The recently enacted Tax Increase Prevention and Reconciliation Act of 2005 includes a measure to discourage tax-exempt organizations from serving as accommodation parties in tax-shelter transactions. I encourage the IRS to use the full weight of its authority to ensure that this provision of the Act is effectively administered.

Following are some of the questions and concerns I have as a result of several Senate Finance Committee ("Committee") investigations. The investigations, for example, highlighted the difficulty in determining when an activity of an exempt organization qualifies as "educational." The investigations also demonstrated the challenges that arise in determining when a "business" activity is unrelated to an organization's exempt purposes or perhaps even confers an impermissible benefit on private persons. As a result, I would appreciate your comments and thoughts regarding the following cases and answers to the questions that follow.

Tax-Exempt Organizations Used for Political Purposes

The staff of the Committee has reviewed numerous documents relating to the charities and social welfare/advocacy organizations with which Jack Abramoff was directly or indirectly associated. In addition, the Committee has reviewed documents of other tax-exempt organizations across the political spectrum with fact patterns akin to those associated with Mr. Abramoff.

A primary concern is that these organizations may be disguising impermissible lobbying and political activities, or activities intended primarily to benefit private parties, by classifying them as "educational" activities purportedly related to the organizations' exempt purposes. Consider, for example, an organization that is tax-exempt under Internal Revenue Code ("IRC") section 501(c)(3) or 501(c)(4) and accepts a payment (designated as a contribution) in exchange for which the organization provides a position paper or holds a conference extolling the contributor's position on a particular issue.

While not part of the Abramoff facts, I am particularly concerned about the circumvention of the requirements of IRC section 527 by the use of 501(c)(4) organizations. Further, I have questions about the use of 501(c)(4) organizations for activities primarily intended to benefit private parties or which appear to have little or no connection to furthering a valid social welfare purpose. I am also concerned that some such activities generate unrelated business taxable income to the organization. Please inform me as to whether and how frequently you receive cases or ruling requests involving these issue and whether you have plans to issue guidance in this area. In addition, I appreciate any general comments or suggestions you may have for the Committee.

National Association of Investors Corporation ("NAIC")

Enclosed is a copy of a letter recently sent to the NAIC. I understand that IRC section 4958 does not cover many of NAIC's transactions because the parties to these transactions were not disqualified persons, but rather were just friends of NAIC's trustees. Please inform me as to whether and how frequently you receive cases or ruling requests that involve private benefits to "outsiders" (i.e., persons who are not disqualified persons under section 4958) and explain how these are currently

resolved. Please also provide information concerning the number of cases with IRC 4958 issues that are currently open, the length of time they have been open, what the expected timeframe may be for resolution, and what the resolution might be. Please also discuss what IRC section 4958 challenges arise when board members are compensated for their dual roles as a board member and as an executive or employee.

The Edward Orton Jr. Ceramic Foundation ("Orton")

Enclosed are materials obtained in the course of the Committee's investigation of Orton. The Committee initiated this investigation based on information received from a small business in Iowa that believes it is significantly disadvantaged because Orton is not subject to tax from income earned from the same activities.

You will note that Orton's primary purpose when it was founded was to further research in the field of industrial ceramics. After reviewing Orton's Forms 990 for the most recent years, it is difficult to disagree with the concern of the Iowa small business "about the direction this non-profit foundation has taken, which appears to be more about profit, accumulating surplus capital and marketing their products, rather than about education and research to advance the ceramic arts". It appears that Orton's resources are disproportionately dedicated to the manufacture and sale of ceramic products rather than research.

You will also note that Orton's tax exemption was challenged in court in 1971. At that time, four judges issued a dissenting opinion challenging the majority's ruling that income from the sale of ceramic products was related to Orton's exempt purpose and therefore exempt from tax. In the thirty plus years since that ruling, Orton's activities with respect to the sale of ceramics products appears to have increased while its educational activities appear to have decreased.

Please inform me as to the challenges that exist in classifying an activity as unrelated to exempt purposes such that income from that activity then is subject to the unrelated business income tax

("UBIT") or in determining whether such activity is so extensive that exemption may no longer be warranted. What test does the IRS use to assess the level of commercial activity conducted by a 501(c)(3) exempt organization? Please also provide information concerning the number of cases involving UBIT issues that are currently open, the length of time they have been open, what the expected timeframe may be for resolution, and what the resolution might be. Please inform me as to what guidance you may be planning to issue in this area.

#### Musculoskeletal Transplant Foundation ("MTF")

Enclosed are copies of the Committee's letter to MTF and MTF's narrative response (without attachments) to this letter. The Committee initiated this investigation due to information that MTF was engaged in a "hostile takeover" of a public company. The facts appeared similar to the Orton case in that a 501(c)(3) entity was in direct competition with a for-profit entity. In MTF's case, however, MTF provides products that generate low or zero margin that for-profit entities generally will not provide.

This case is also interesting as it appears that MTF and other non-profit entities dominate this market which may suggest the activity is appropriately conducted by charitable organizations. In some cases, IRS rulings state that providing goods or services at or below cost might be an exempt purpose. Nevertheless, the same questions with respect to UBIT that apply to Orton apply to MTF as well. I would appreciate understanding to what extent you utilize industry analysis and statistics when determining whether an activity results in UBIT.

#### Officer/Director Compensation & Trustee Fees

The staff of the Committee continues to study compensation issues related to private foundations and public charities, including charitable trusts. In your confirmation hearing on March 8, 2004, you pledged to work with me on this issue. In written communication subsequent to the hearing, you indicated that you wanted to wait for the IRS Office of Exempt Organizations to make progress in its study of executive compensation. I would appreciate an update on the work you are doing in this area

in light of this study.

The letter to the NAIC raises some compensation issues that are not unique to NAIC, particularly the issue of board members being compensated for both board service and for their duties as an executive or an employee. A similar issue with respect to certain charitable trusts arose during the development of legislation regarding supporting organizations. Representatives of several trusts have informed us that trustee compensation is often dictated by trust documents, which fall under the jurisdiction of state and local governments. More importantly, these trusts argue that trustee compensation is reasonable and meets the requirements of IRC section 4958 because the trust document limits compensation. However, my staff found that the governing bodies of such trusts often perform no analysis to determine whether compensation is reasonable, that is, whether a trustee's fees are justified in light of the services performed by the trustee.

For example, a trust may claim that trustee fees are reasonable, because the fees are only a  $\frac{1}{4}$  percentage point of total trust assets. Thus, a trust with \$500 million of assets might pay a trustee \$1.25 million for trustee fees. Yet, there may be few or no records or other forms of accountability to substantiate what services the trustee is providing for these fees. Presumably, a trustee of a supporting organization with named beneficiaries is simply transferring money to the supported organizations, which raises the question of whether compensation calculated as a percentage of total assets is reasonable. This question arises even more so when someone other than the trustee is compensated for investment advisory, money management and bookkeeping services (in other words, when the trustee is not required to pay such amounts out of the trustee's fee).

If, in fact, a trustee incurs expenses with respect to administering the grants or running the trust, it would seem that such expenses should be separately reported on the Form 990. Categorizing such expenses simply as trustee fees provides no accounting or transparency with respect to how trustee fees are spent. A question also arises as to whether a trustee should be compensated for serving on the board of a supported organization since such service may be as a result of the trust's supporting organization status. A further problem arises when there are so few trustees that there is no independent review of trustee compensation.

Although trusts may be governed by state and local authorities, particularly the courts, it is not clear that such authorities are providing significant oversight regarding the reasonableness of compensation or, more specifically, considering reasonableness under IRC section 4958 when reviewing trustee compensation. There is no guarantee that such compensation is regularly reviewed by relevant state or local authorities, particularly when a trust document may limit trustee compensation to a certain percentage of assets. It is troubling that a trustee's fees may increase simply because the value of assets has increased while there may be no corresponding increase in the services provided by the trustee.

I would like your general comments and response to the above and also please inform me as to whether you are considering the issue of whether officers, directors and trustees are compensated for their dual roles as a board member and as an executive or employee. I am particularly interested in how IRC section 4958 would be applied to organizations that do not distinguish between these roles and also whether Form 990 accuracy related penalties could be imposed in such cases.

### Non-profit Hospitals

I strongly believe that, given the rapidly changing nature of the health care industry, the regulations and guidance with respect to tax-exempt organizations in this sector need to be monitored and updated on a continuing basis. Some areas in which your office should be particularly engaged include the definition of charity care, the requisite level of charity care, the definition and level of community benefit, the definition of joint ventures, joint ventures involving non-profit hospitals, the payment of excessive compensation and the use of tax-exempt bond proceeds.

I have provided Steve Miller, Commissioner, IRS Tax-Exempt and Government Entities division, with a summary of the responses received in response to my letter to ten specific hospitals and have invited his staff to review the supporting documentation. I encourage your staff to work closely with his staff to study this sector. Please explain whether, and to what extent, your staff is involved with the other projects and studies conducted by his staff, such as credit counseling, down payment assistance and political activities.



I understand denials of new requests for tax-exempt status and revocations of tax-exempt status of existing organizations must be approved by your staff. Please explain your staff's involvement in this process and provide statistics on the number of revocations and denials issued since 2000, the types of organizations involved, and the length of time involved in issuing these revocations and denials. Please also include the number of times that your office disagreed with the recommendation of TE/GE staff as to a revocation or denial (or proposed significant modification in the organization's activities), year by year since 2000. Please also provide information as to the numbers of lawyers dedicated to tax-exempt organizations and tax-exempt bonds each year since the IRS reorganization in 2000 and include the number of retirements or losses from other causes and hires for each of those years.

Please provide the information requested within thirty days.

Sincerely,

Charles E. Grassley

Chairman